EXHIBIT 3

ORIGINAL

RECEIVED
OCT 16 2:11:11

U-95-38

STATE OF ALASKA

THE ALASKA PUBLIC UTILITIES COMMISSION

Before Commissioners:

Sam Cotten, Chairman
Alyce A. Hanley
Dwight D. Ornquist
Tim Cook
James M. Posey

In the Matter of the Request by GENERAL COMMUNICATION, INC., for Waiver of 3 AAC 52.355(a) and Approval of a 50-Site Demonstration Project	U-95-38

REVISED REDACTED STAFF REPORT

The Commission Staff submits the attached revised redacted version of its report on the General Communication, Inc. (GCI) 50 site DAMA Project. This version provides the text of the Staff report, but excludes the attachments, consistent with the agreement of GCI and Alascom, Inc.

DATED: October 14, 1998.

BRUCE M. BOTELHO
ATTORNEY GENERAL

By: Ron Zobel
Ron Zobel
Asst. Attorney General

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

STATE OF ALASKA

THE ALASKA PUBLIC UTILITIES COMMISSION

Before Commissioners:

Sam Cotten, Chairman
Alyce A. Hanley
Dwight D. Ornquist
Tim Cook
James M. Posey

In the Matter of the Request by GENERAL COMMUNICATION, INC., for Waiver of 3 AAC 52.355(a) and Approval of a 50-Site Demonstration Project	U-95-38

STAFF REPORT

On June 22, 1995, GENERAL COMMUNICATION, INC. (GCI), filed a request for waiver of 3 AAC 52.355(a) to begin a demonstration project in which GCI would construct new satellite communications facilities in 50 locations in rural Alaska. The Commission granted approval of the GCI Demonstration Project[1] and required that various market and company data be regularly filed by both GCI and by Alascom, Inc. d/b/a AT&T Alascom (Alascom). Staff was directed by the Commission to file a report of its analysis of the 50 site data. Staff's analysis will include data for the 50 GCI Project sites, as well as for six regional center

[1]The Commission granted approval of the project to at least January 1, 1998.

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

locations[2] associated with the Project. This report covers conditions up to the end-of-year 1997.

Summary

The GCI Demonstration Project is still evolving as a small number of GCI sites were not in service as of March, 1998, and several local exchange sites have yet to convert to equal access. As the Project is in transition, the Project's ultimate profitability and impact on customers and the public interest can only be estimated.

In general, quality of service and ability to transmit data has improved for customers served by the GCI DAMA Project. In every location some portion of the customer base employs GCI services, whether it be credit card or other form of service. Many customers have experienced lower bills as a result of a competitive choice and improved subscription to Alascom optional calling plans. GCI facilities in these locations also provide customers with a backup communications path in the event of failure of the Alascom system. Overall, customers in the GCI Project area appear better off with the Project than without the Project.

At the same time, issues exist over the financial success of the Project. GCI invested significantly greater amounts and will likely incur greater annual expenses than first

[2]Barrow, Bethel, Dillingham, King Salmon, Kotzebue, and Nome.

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

anticipated when the project was proposed to the Commission. Furthermore, the Project overall does not currently appear profitable, though that could change in future years as revenues grow or if GCI can decrease costs. Many individual sites however due to high cost and low demand for service, may never be profitable on a stand alone basis.

For the 50 sites, not including the regional centers, GCI's reported average retail revenue per site of about $9,000 in 1997.[3] In comparison, the average investment per site was around $329,000, and average expenses identified by GCI were about $55,000 per each of the 50 non-hub sites. Staff believes total expenses could be $26,800 per site higher than reported by GCI. If debt coverage and a return on equity were considered, costs would be significantly higher. The above conditions signal a potential problem and indicate the need for continued reporting by Alascom and GCI on the project.

GCI losses in the first years of operation would not be surprising for a project of this scope. GCI may be willing to accept some losses for its Project if it can achieve other indirect benefits such as increased contracts with high volume urban customers requiring some rural communications.

The profitability of GCI sites will affect whether GCI will be able to serve on a facilities basis statewide, how fast

[3]GCI reported switched retail revenues. No GCI private line revenues were included. Alascom customer data would suggest few private line customers in the 50 sites.

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

GCI will be able and willing to expand facilities to new areas, whether GCI will have a financial incentive to relocate some of its earth stations to more profitable sites, and whether the current system is viable in the long term absent subsidy.

To date, the Project has had a variety of affects on Alascom, many of them minor. Alascom recently upgraded some of its rural facilities to DAMA technology. Whether the upgrade was the result of competitive pressure, a response to customer dissatisfaction, or a planned network upgrade remains unknown. Alascom has not deployed DAMA technology as fast as originally planned. Only 60 DAMA sites, out of the 92 sites planned in 1996 were deployed in 1997. Alascom reports improved service quality associated with its DAMA sites. Alascom appears financially strong even after construction of 60 sites under its DAMA project.

Generally the revenue and minutes impact of the demonstration project on Alascom have been most evident in a few key regional hub locations. For example, Alascom reported a $2,612,466 revenue loss for the six regional hubs and a revenue gain of $360,000 overall for the 50 non-hub sites. As the hubs were open to facilities competition under 3 AAC 52.355, losses might have occurred even if the Project did not exist. It is more likely however that because of the Project there was increased competition at the hub sites and more customers interested in selecting GCI given its new network serving the surrounding region.

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

Observed revenue reductions according to Alascom, are not solely associated with lost customers to GCI and instead were also attributable to Alascom customers choosing an Alascom calling plan providing lower rates. This could indicate that while Alascom rate schedules are offered statewide, in compliance with 3 AAC 52.370(a), advertising and marketing of the services are to some degree geographically targeted to the competitive areas.

Alascom could experience additional revenue losses once equal access is available in all of the 50 sites. A key issue to evaluating the effect on the incumbent is both how much revenues are lost to the competition, and how fast the change in revenue occurs. For example, Alascom may be able to retain close to its existing profitability if revenue losses due to the Project are offset by annual traffic growth (5%), reduced costs, and increased efficiency. Currently statewide traffic growth would significantly offset Alascom's reported change in minutes associated with the 56 sites. Of these 56 sites, the 50 non-hub locations collectively showed a net gain in Alascom minutes in 1997. On a total company basis, Alascom remains profitable and there is no evidence that the current level of competition with GCI Project sites has led to rate increases or has unduly affected Alascom retail revenues, profits, ability to obtain equity and debt financing, and ability to invest in infrastructure. This would suggest that in the short term, allowing more small sites to be added to the Project may create greater benefit than detriment to the customers.

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

The impact of opening the market as a whole depends upon where and how quickly GCI will invest in rural earth stations. In 1997, GCI operated at a loss and may not be financially in a position to quickly build duplicate facilities statewide, especially given the profitability of the Project to date.

As a last point, DAMA technology and earthstation upgrade for both GCI and Alascom appear to be going slower than originally expected, indicating that statewide deployment may take years.[4]

The following sections of the Staff report will present an individual review of the project status, investment, expenses, changes in revenue, profitability, customer counts, minutes, quality of service, local exchange effects, and other issues.

Project Status

GCI received approval for its Project on November 9, 1995, and planned to install equipment at the 50 sites during 1996.[5] The first GCI Demonstration Project site was placed in service in October, 1996, with a large number of subsequent sites placed in service during 1997. See Attachment 1. As of March

[4]By these comments, Staff is not suggesting that DAMA is necessarily the best technology for serving each site.

[5]Testimony of Richard Dowling at 11, U-95-38, August 25, 1995.

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

1998, all GCI sites had been installed, though four sites were not in service.[6]

GCI requested interconnection with the local exchange carriers (LECs) at each of the 56 sites. LEC deployment of equal access interconnection occurred at only ten sites in 1997. Twelve sites were planned to have equal access by end of July 1998, and all sites were expected to have equal access by February 1, 1999. See Attachment 1. The full effect of the GCI Demonstration Project cannot be observed until after all sites are on line and equal access is available.

Alascom is in the early stages of deploying its DAMA technology. Alascom began turning up its DAMA technology in January 1997. Sixty locations were made operational by end-of-year 1997. This is a 33% reduction from the 92 DAMA locations originally planned. Alascom most recently stated it intends to serve 82 villages with 75 DAMA stations. A comparison of Alascom's original plan and current installation of DAMA technology is provided as Attachment 2.

Conclusion

DAMA technology expansion and upgrade for both GCI and Alascom are going slower than expected, indicating that statewide provisioning of DAMA technology may take years. Though over two years had passed since Commission approval was granted, GCI had

---

[6]Buckland, Nelson Lagoon, Shungnak, Wainwright.

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

been unable to put all of its 50 selected sites in service. LECs will not implement equal access at all of the 56 sites until 1999.[7] Some customers will be unable to take advantage of full 1+ dialing access to competitive long distance services until 1999.

Investment

Investment in the Project has exceeded GCI's stated expectations and was steadily growing between 1996 and 1997. In 1995 GCI stated it was "risking up to $17 million" in the demonstration project.[8] At that time total capital costs for the project were estimated at $12.3 M, and the locations to be deployed had not been finalized.[9]

By December 31, 1997, GCI had invested $27 M in the project and average earth station investment for the original 50 sites was about $329,000 per site (excluding common costs and construction in progress). Attachment 3 provides the Project investment over time for the 50 DAMA sites and the six regional hubs.

GCI investment appears to have grown across virtually all portions of the DAMA system. Current DAMA Project investment

---

[7]Equal access interconnection has been a contentious issue between GCI and some of the LECs. This Report does not express a position on the reasonableness or unreasonableness of the timing, methodology, or other issues related to equal access conversion.

[8]Testimony of Ronald A. Duncan, at 10, U-95-38, 8/25/95.

[9]Duncan Testimony, Attachment RAD-4.

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

represents about 12% of GCI's total company plant and equipment ($224.4 M) as of December 31, 1997.[10]

Conclusion

GCI investment in the project has greatly exceeded original expectations. Investment has grown significantly over time and it is unknown when it will stabilize, though that may occur soon as the majority of sites are now in service.

Expenses

GCI originally estimated total annual operating and maintenance costs for the project at about $3.2 M.[11] Staff believes that 1997 expenses exceeded that estimate.

For the 56 sites GCI reported expenses of about $1,139,670 for 1996, and $3,376,556 (about $60,000 per site) for 1997.[12] GCI telephonically indicated that its reported expense data was mostly for marketing, and operations, maintenance and repair costs. The data does not appear to include other costs of service such as transponder fees, off-network termination costs,

---

[10]GCI interexchange carrier Annual Report pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934, for the fiscal year ended December 31, 1997, at 23. Data represents property and equipment plant in service, not net of depreciation or amortization. Net property and equipment in service for 1997 was $184 M.

[11]Duncan Testimony at Attachment RAD-4.

[12]The GCI 1997 expense figure includes intrastate and interstate access costs of $644,931.

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

debt coverage, return, depreciation, and possibly other internal GCI costs. Expense and investment ratios further support that the reported $3,376,556 expense figure is low. Using the $3.4 M figure, the Project's expenses to investment ratio is 12.5%, while GCI's total company expense to investment ratio is about 93%. Similarly, while the ratio of Project to total company plant was about 12%; the ratio of Project to total company expenses was only 2%.

If expenses and investment in the Project are comparable to GCI expenses and investment overall, then Staff would expect Project expenses for 1997 to be higher than reported. Staff estimates additional GCI expenses of $1.5M as a very rough, adjustment to account for depreciation and amortization, transponder costs, and fees paid to other carriers for termination of traffic. All costs may not be included in Staff's analysis. The $1.5 M figure does not include an adjustment for debt coverage or return on investment.

As an alternative for comparison to Staff's $1.5 M adjustment, Ben Johnson during his testimony before the Commission estimated GCI's annual cost factor, that accounts for such items as depreciation and the cost of money, at about 20% (which he claimed was a comparable factor many companies used for various types of telephone plant.)[13] If the 20% factor were applied to GCI's $27 M investment, the annual cost associated with capital

[13]Testimony of Ben Johnson, Ph.D. on behalf of the Staff, at 17, U-95-38, 10/17/95.

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

investment would be about $5.4 M. Adding the $5.4 M to GCI's reported $3.3 M expense and access costs would result in costs of $8.7 M, with some costs (e.g., transponder costs) not included in the total.

Staff employs the $1.5M expense adjustment in the remainder of its analysis, with the understanding that this adjustment may be low. Staff's adjusted expense figure for the GCI Project for 1997 would be about $4.9 M, with an annual average expense per site per year of about $87,000 for the 56 sites.

GCI expenses for 1996 and 1997 might not be typical for future years as the project remains in a transitional phase. Not all earth stations were in service in 1997 and access costs at some locations may increase as the location is converted to equal access and more minutes of traffic are carried. GCI may be able to reduce its expenses given the experience it has gained managing the Project. GCI expense data also does not reflect cost savings GCI achieved by avoiding wholesale fees to other carriers since GCI would carry much of its traffic over its own equipment.

Little comparable expense data is available regarding Alascom's DAMA project expenses. Staff cannot verify Alascom's claim that by initial estimate, costs of deploying Alascom's DAMA system arrived within budget and that overall on-going costs for provision have not changed dramatically. Alascom did not quantify its statement except to report a $6.5M "significant change in costs" associated with the demonstration project sites.

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

Conclusion

Actual expenses for the GCI project in 1997 were over the level originally planned for the project. Average costs per site appear greater than existing average revenues for the 50 non-hub sites.

Change in Revenues

Revenue data provides critical information regarding the effects of competition on the incumbent and is a key component for assessing the financial viability of the GCI project.

Total GCI project retail revenues reported in 1997 were $2.8 M, a substantial increase from 1996. Most revenues (84%) were concentrated in the 6 regional hubs. The remaining 50 sites were accountable for only $448,729 total retail revenues.

In 1997, GCI held 17% and Alascom 83% of the market revenues for the 56 sites. In equal access locations, GCI held about 32% of the 1997 revenues. In non-equal-access locations, Alascom retained a 92% share of the revenues. See Attachment 5.

The above trends indicate that GCI DAMA Project retail revenues are growing and will likely continue to grow as equal access availability increases. Revenues may also grow as the result of traffic stimulation effects. Revenues for the GCI Project (and for Alascom) may increase in future years depending upon the provision of federally funded school, library, and rural health care programs and other new service offerings.

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

The project revenues reported by GCI (as documented above) did not include wholesale like revenues from other carriers such as MCI and Sprint that "purchase" GCI services. In specific, GCI has agreements to terminate all Alaska-bound MCI and Sprint long distance traffic while MCI and Sprint will terminate portions of GCI's interstate and international traffic on their systems.[14] GCI reports that revenues attributable to the MCI and Sprint agreements make up about 26% of total GCI revenues[15] and about 35% of GCI long distance revenues. The exact net MCI and Sprint revenues associated with the 56 site Project were not reported. As a vary crude, optimistic estimate, Staff attributes $1 M or 35% additional revenues above the Project retail revenues to account for revenues generated by MCI/Sprint.

Alascom reported no significant change in 1996 demand, revenues, or costs of service as a result of the GCI Project. As more GCI sites came "on line" in 1997, Alascom reported both significant reductions and increases in revenue by DAMA site.[16] Alascom's change in revenue data reports only revenue associated with originating minutes of calling.[17] See Attachment 4 and 5.

---

[14]GCI SEC Annual Report for year end 12/31/97 at 11, 12. MCI agreed to terminate all of GCI's long distance traffic terminating in the lower 49 states excluding Washington, Oregon, and Hawaii. Sprint agreed to terminate all of GCI's international traffic.

[15]GCI SEC Annual Report for end of year 12/31/97 at 11.

[16]Alascom provides no documentation describing how it calculated its reported changes in revenue.

[17]It is unclear the extent to which terminating retail revenue (continued...)

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

Major reported revenue losses experienced by Alascom for the project area appear to be limited to a small handful of locations. Out of the 56 sites, the six regional hubs account for 52% of all Alascom site revenues and these sites experienced $2.6 M in revenue losses. Collectively the 50 remaining sites represented a net positive "significant change" in revenue of about $361,000.

In its filing of March 31, 1998, Alascom indicated that individual customer revenues decreased on average due in part to customers selecting optional calling plans and moving from the higher basic rate schedule. This would suggest that prior to GCI's Demonstration Project, customers at the 56 sites were paying more for telecommunications services on average than their urban counterparts who regularly employ optional calling plans.

Alascom's statement that revenue losses were in part caused by customers using calling plans is supported by GCI data. Data indicates there is no direct and obvious correspondence between GCI revenue gains in 1997 and Alascom revenue losses. The table below provides an example of the variation between GCI and Alascom revenues for sample locations:

---

[17](...continued)
should be considered in this analysis. In any event, the only retail revenues likely excluded from Alascom's report would be for calls originating outside, but terminating within, the 56 site system. Such originating calls from rural locations may be low as the GCI DAMA system was designed to cover a region's community of interest. Alascom unreported revenues for originating calls from urban locations to the 56 sites may for the most part be less of an issue as facilities based competition has been available in urban areas for a number of years.

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

Location	Alascom Revenue 1997	Alascom Change in Revenue	GCI Revenue 1997
1	$1 M	($900,000)	$150,000
2	$70 k	($45,000)	$ 2,000
3	$200 k	($40,000)	$ 80,000
4	$100 k	$20,000	$ 4,000
5	$100 k	$15,000	$ 10,000

Over the entire 56 site system, Alascom reported a relative change in annual revenue of ($2.2 M) by end-of-year 1997.[18] As previously stated, the $2.2 M figure occurred in a year where not all sites were equal access sites. Ignoring traffic stimulation, Staff projects that Alascom might have had a revenue change of ($3.7 M) by end-of-year 97 if all sites were equal access sites.[19] In comparison, Alascom total company operating revenues for 1997 were $235.5 M, with intrastate revenues at $64.5 M. Alascom reported Total Operating Income and Intrastate Operating Income of $28.4 M and $1.5 M respectively, in 1997.[20]

---

[18]Alascom does not indicate the jurisdictional nature of the data. Staff assumed the change in revenues data represented both interstate and intrastate losses.

[19]Based on equal access locations experiencing a reported change in revenue of about 23.6% in 1997 and $9M in revenues for non-equal access sites. See Attachment 5, page 2.

[20]Based on Alascom 1997 annual report data.

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

Conclusion

So far Alascom does not appear to be significantly harmed by the Project. The majority of retail revenue losses appear attributable to a small number of sites (mostly the larger population locations) where facilities based competition is already allowed. Reported Alascom retail revenue losses appeared measurable, but minor (1%) compared to overall Alascom revenues. One of the primary causes of Alascom's revenue reduction appeared to be customers selecting better calling plans. Alascom did not report material changes in wholesale revenues associated with the Project.

In the 56 site system, though GCI revenues are quickly growing, GCI holds relatively low overall market share (17% based on retail revenue). GCI's has a higher market share (32%) in equal access locations, indicating GCI revenue are likely to grow as equal access becomes available system wide. If all sites were converted to equal access, Staff estimates additional revenue losses of $1.5 M for Alascom, ignoring traffic stimulation affects.

Profitability

Staff believes that the GCI Demonstration Project in 1997 was not profitable overall:

Expenses	($2,732,000)
Access	($ 644,931)
Staff Exp. Adj.	($1,500,000)
Revenue	$2,770,297
Staff Revenue Adj.	$1,000,000
Net:	($1,106,634)

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

Only one of the non-hub sites, Unalakleet, had equal access for over 11 months of 1997. Unalakleet is a relatively large site compared to most of the non-hub Project sites. For this site, 1997 revenues did not appear to exceed costs:

Expenses on average per site:	($ 48,800)
Access for Unalakleet:	($ 44,500)
Staff Exp. Adj.	($ 26,800)
Revenues for Unalakleet:	$82,000
Staff Rev. Adj.	$28,700
Net:	($ 9,400)

Below is a similar calculation for Ekok, a small site that had equal access beginning mid-May, 1997:

Expenses on average per site:	($ 48,800)
Access for Ekok:	($ 9,200)
Staff Exp. Adj.:	($ 26,800)
Revenues for Ekok:	$ 9,000
Staff Rev. Adj.:	$ 3,100
Net:	($ 72,700)

Staff's above estimates do not include debt service coverage (which could be significant in magnitude), a return on equity and possibly other costs.[21] Net losses would be signifi-

[21]Staff recognizes that its $1.5 M expense adjustment may not have considered all costs and revenues associated with the Project. To the extent GCI has better data, it may supplement the record on this point. Staff believes that to the extent its estimate is in error, it underestimates Project expenses relative to revenues.

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

cantly higher given costs calculated using Ben Johnson's approach.[22]

Staff anticipates project profitability will improve as GCI attains equal access in its remote locations and as a result, increased revenues. Staff estimates that once equal access is available at all sites, GCI could achieve about $2.4 M in additional retail revenues to offset a portion of the overall project losses.[23] Some of this revenue increase will be offset by access costs associated with the increased traffic. Traffic stimulation and increased revenues from other services (e.g., private line, schools) would also likely increase profitability.

In addition, while the entire project or any individual site might not be profitable on a *stand alone basis*, it still may be advantageous to GCI if it can reduce GCI's total costs of serving high cost areas or can increase GCI revenues in areas outside of the Project. For example, GCI likely achieved some cost savings from the Project as it would no longer need to purchase wholesale transmission and switching services from Alascom for services to the 50 sites.[24] Revenues at locations

---

[22]See discussion of page 10-11.

[23]Assuming revenues for the non-equal-access sites will track that for the equal-access sites where GCI was able to achieve about a third of market revenues.

[24]Staff does not have average cost information, but the Alascom wholesale rates for a Category III to Category III call during peak hours is about $.30/minute. In comparison, GCI total unadjusted expenses per minute were about $.39/minute for the Project. Expenses, after Staff's adjustment, were about

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

outside of the Project may improve if GCI is better able to win critical urban/hub customers needing access to rural areas. As previously noted by Ben Johnson in his testimony on this matter,[25] introduction of higher quality service may also i) improve the degree of traffic stimulation, improving revenues, ii) enhance quality of service and GCI's physical presence in the rural areas, allowing GCI to increase its share of the market statewide, and iii) enhance GCI's image as a state-of-the-art, full service, statewide carrier.

Most importantly, the profitability of the GCI project in 1997 reflects a project under development. Staff believes that some start up losses for a project of this size and scope would not be unusual. At the same time, the degree of profitability for this project suggests continued reporting by Alascom and GCI for the project area.

GCI on a total company basis had a net loss of $2.2M in 1997.[26] The company attributed its loss to additional depreciation, amortization and interest expenses resulting from the cable company acquisition in October 1996 and startup losses from GCI's entry into the local market. In comparison, for the years 1996 through 1994, GCI typical net earnings were slightly above $7 M each year. In 1997, GCI had a debt to equity ratio of about

---

[24](...continued)
$.60/minute.

[25]Ben Johnson testimony at 17, 10/95.

[26]GCI SEC Annual Report at 26.

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

55%/45%; long term debt of about $250 M; and total assets of $545M.[27]

In comparison, as of December 31, 1997, Alascom for its interexchange operations (both interstate and intrastate) had no long term debt; approximately $370 M in stockholder equity; $89.5 M in retained earnings; $25.5 M net income and total assets of $426.7 M.[28] These figures reflect Alascom's status after installation of 60 DAMA sites.

Conclusion

Staff concludes that in 1997, Alascom was more profitable than GCI, and was better able to fund any needed investments due to its low debt and high retained earnings. At the same time, Alascom investment in rural areas (evaluated solely on number of DAMA sites installed), was only slightly greater than that for GCI, and below planned levels. This suggests factors outside of Alascom's ability to finance infrastructure are limiting the rate of facilities upgrade in rural areas. Neither the GCI DAMA project nor Alascom's own DAMA project would appear to have unduly compromised Alascom's ability to fund future investment or maintain a profit.

The GCI project overall would appear unprofitable in 1997. To the extent GCI has earned profits on its project, those

---

[27]GCI SEC Annual Report at 26.

[28]Alascom 1997 Annual Report at Schedule B-1.

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

profits are mostly associated with its six regional hubs. Some of the smaller GCI DAMA sites may never be profitable on a stand alone basis. Profitability is expected to improve in the future. At this stage Staff is hesitant to suggest when the Project will become profitable. GCI data raises uncertainty as to whether GCI has the financial resources in the short term to expand its DAMA investment to cover all of Alaska, or the inclination to expand statewide if individual sites continue a pattern of unprofitability.

Change in Customers

For 1997 in the 56 sites reviewed, Staff estimates that Alascom lost on average, about 28% of its presubscribed customer base to GCI as a result of competition in the interexchange market.[29] The 28% figure includes data for locations where there are no presubscribed GCI customers as there is no equal access. In the areas with equal access during 1997, GCI's presubscribed customer share was much higher and averaged 46% for the project. See Attachment 4. Staff estimates that GCI's customer share may approach the 46% level project wide once all locations are converted to equal access.

[29]This estimate was calculated by comparing total GCI PICC access lines to total Alascom MTS customers as of end-of-year 1997. Staff has no data to identify new customers to the system separately from existing Alascom customers converting to GCI.

Four regional hubs[30] of the 56 sites reviewed appeared to account for the majority of presubscribed customers lost by Alascom to GCI. In specific, these four locations account for 89% of all presubscribed customers switched to GCI, with the remaining 52 locations accounting for only 11% of the switched customers.

While customer information reflects the extent to which the public has exercised a choice in carrier, it does not always provide a good indicator of the impact of competition on the incumbent carrier. Average customer count data does not reflect the extent to which a carrier has been able to attract the most profitable, high volume customers. Secondly, the GCI customer data looks unusual[31] and does not represent a full "apples to apples" comparison to the Alascom data. This suggests the Commission should place limited reliance on the customer data.

Conclusion

GCI continues to gain customers, with most gains in areas with equal access.

---

[30]Barrow, Bethel, Nome, and King Salmon.

[31] For example, Staff cannot explain why GCI reports that in Barrow it has over 1000 presubscribed customers, but only 87 customers have used some form of GCI services. GCI and Alascom data may be slightly different as GCI reported customer access lines assigned to GCI while Staff believes Alascom reported customer counts.

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

Change in Minutes

Among the 56 sites, Alascom retains about 93% of the total market minutes, with GCI at 7% of the market minutes (1997 data). Even in the larger population centers where competition with GCI is likely to be strongest, Alascom has retained a high percentage (between 92% and 98%) of market minutes. Alascom in its March 31, 1998 report indicated it had not observed an increase in individual customers' minutes of use in the DAMA locations.

Six regional hub sites collectively account for 52% of all Alascom minutes for the 56 site system. For Alascom, the average minutes per site for these six sites is ten times the average minutes per site for all other sites. For GCI, these same six sites represent about 35% of all GCI reported minutes for the project sites.

Traffic growth statewide may compensate Alascom in part for minutes and revenue losses associated with the Project:

		Minutes	
Access Minutes:	1994	614.6 M	
	1995	656.4 M	7% growth
	1996	686.8 M	5% growth
	1997	718.2 M	5% growth

1998 Expected Growth statewide (GCI & Alascom): 18 M call minutes
Alascom change in minutes in 1997 ALL 56 SITES:(18.6M) call minutes
Alascom change in minutes in 1997 for 50 NON-HUB SITES:
1.1 M call minutes

Based on the above, traffic stimulation affects may significantly offset a portion of minute losses experienced by Alascom for the 56 sites and would likely cover future losses for the 50 non-hub sites.

The GCI minutes data for its six hubs looks unusual low. Specifically, while GCI has a 25% revenue share for its hubs, it only has a 4.6% share of the minutes. In addition, Staff cannot explain why Unalakleet would have a higher minutes count than any other GCI location (including Nome, Barrow and Bethel). Staff therefore recommends that the Commission place less reliance on the GCI minutes data than other reported data unless the unusually low minutes count is explained.

Conclusion

Alascom continues to have a high share of the market minutes for the Project sites. Most minute losses for Alascom are concentrated in the six regional hubs. Overall the 50 non-hub Alascom locations did not experience a loss in traffic.

Quality of Service

GCI stated in testimony in Docket U-95-38 that the new equipment it would install under the demonstration project would significantly upgrade and enhance the interexchange telecommunications services available in its 50 rural locations. GCI offered telemedicine and distance education as examples of the services that might be provided under its project. Alascom in its March

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

31, 1998, report in Docket U-95-38 stated that customer feedback suggests that call quality between DAMA locations has improved.

Staff agrees DAMA technology has improved quality of service and data transmission speeds for customers compared to older analog satellite equipment. DAMA technology provides more throughput in a satellite transponder, leading to a more efficient transponder cost. In addition, the DAMA technology will eliminate double satellite hops for customers who originate calls that are terminated on the same DAMA system, reducing transmission delay and improving quality of the talk path.

Staff notes that the expected customer data rates for both the GCI and DAMA sites is about 14.4 Kbps. While this is likely an improvement over data rates under the Alascom analog system, the State Telecommunications Modernization Plan (3 AAC 53.705(g)) requires that both IXCs by February 13, 2003, provide switched digital service at 56 Kbps to any customer upon request. Limitation in the data rate may be a function of satellite communications as currently configured rather than a feature related solely to DAMA technology.

Impact on Interconnecting LECS

LECs faced increased costs to interconnect with GCI and provide full equal access services. Costs of equal access conversion were estimated by the local carrier as between $30,000 and $64,000 per site for locations served by the Arctic Slope

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

Telephone Association Cooperative[32] and between $0.00 and $39,800 per site for TelAlaska.[33]

The Commission has ordered GCI financially responsible for all reasonable and necessary costs incurred by local exchange companies to interconnect with GCI's equipment, for costs not recoverable through access charge revenues.[34]

Conclusion

Staff concludes that to the extent there are increased GCI Project related LEC costs of interconnection and equal access, there is no evidence such costs will not be recovered by the LEC. The direct impact of the Project on LECs should be minimal if the reasonable interconnection and equal access costs can be recovered through access rates and other charges. Increased access rates however, could increase interexchange system costs.

<u>Other Reported Factors Affecting the Market</u>

In its December 1996 report, GCI claimed that Alascom's CustomNet offering had induced significant customers to accept term commitments before a competitive choice was available.

---

[32]There was a dispute between GCI and various LECs concerning the provisioning of equal access and associated cost recovery. The costs identified by Staff are for one of three upgrade options identified by ASTAC in a letter dated December 6, 1996, between ASTAC and Marie Matthews of GCI.

[33]Exhibit 4, Page 1 of 1, Interior and Mukluk's Answer to GCI's Complaint, U-97-109, July 7, 1997.

[34]Order U-95-38(9), at Ordering Paragraph 1(f). See also Orders U-95-38(12), U-97-109(1).

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

Comparison of 56 Sites to the Statewide Network

There are about 254 exchanges in Alaska, a small number of which are located in urban areas.[35] The 56 sites under review therefore represent about 20% of the total Alascom rural statewide network. As a very rough estimate, the effects of the GCI Demonstration Project may be about one fifth of what could occur if the project were broadened statewide. For example, if the same extent of investment is needed statewide as occurred on the Project, GCI might need to invest about $75 M more in earth station equipment to provide DAMA coverage to the entire state.[36] As previously stated, it is unclear whether GCI is financially able to make such an additional investment at this time.

Respectfully submitted this 8th day of September, 1998.

Lorraine Kenyon
Common Carrier Specialist

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

---

[35]Alaska Telephone Association, 1997-1998 statistical information at 1.

[36]DAMA may not be the best technology for all sites. Estimates were based on existing direct investment of $19 M for 50 sites.

ORIGINAL

RECEIVED
A.P.U.C.

98 OCT 14 AM 11:11

STATE OF ALASKA

THE ALASKA PUBLIC UTILITIES COMMISSION

Before Commissioners:

Sam Cotten, Chairman
Alyce A. Hanley
Dwight D. Ornquist
Tim Cook
James M. Posey

In the Matter of the Request by GENERAL COMMUNICATION, INC., for Waiver of 3 AAC 52.355(a) and Approval of a 50-Site Demonstration Project	)))))	U-95-38

CERTIFICATION OF MAILING

I, Lee D. Ault, certify as follows:

I am an Administrative Clerk II in the offices of the Alaska Public Utilities Commission, 1016 West Sixth Avenue, Suite 400, Anchorage, Alaska 99501.

On October 14th, 1998, I mailed copies of

REVISED REDACTED STAFF REPORT

in the proceeding identified above to the persons indicated on the attached service list.

DATED at Anchorage, Alaska, this 14th day of October, 1998.

Lee D. Ault

Lee D. Ault

Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

SERVICE LIST U-95-38

October 14, 1998

Joseph M. Moran, Esq.
Delisio, Moran, Geraghty & Zobel
Counsel for Artic Slope Telephone
Association Cooperative, Inc.
943 West Sixth Avenue
Anchorage, AK 99501-2033

James Rowe
Director
Alaska Telephone Association
201 E. 56th Avenue, Suite 114
Anchorage, AK 99518

Heather H. Grahame, Esq.
Michelle A. Stone, Esq.
Bogle & Gates P.L.L.C.
Counsel for OTZ Telephone
Cooperative, Inc, and
TelAlaska, Inc
1031 West Fourth Avenue, Suite 600
Anchorage, AK 99501

James R. Jackson, Esq.
Regulatory Attorney
General Communication Corp.
D/b/a General Communication,
Inc., and d/b/a/ GCI
2550 Denali Street, Suite 1000
Anchorage, AK 99503-2781

Calvin K Simshaw, Esq.
Corporate Counsel
Telephone Utilities of the
Northland, Inc.
P.O. Box 9901
Vancouver, WA 99668-8701

Robert E. Stoller, Esq.
Counsel for Bristol Bay Telephone
Cooperative, Inc.
Suite 3-640
800 East Dimond Boulevard
Anchorage, AK 99515

A. William Saupe, Esq.
Asburn & Mason
Counsel for Alascom, Inc. D/b/a
AT&T Alascom
1130 West Sixth Avenue, Suite 100
Anchorage, AK 99501